



Legal Office
P.O. Box 942707
Sacramento, CA 94229-2707
(916) 795-3797, FAX (916) 795-3659

February 21, 2007

AGENDA ITEM 3

TO: MEMBERS OF THE BENEFITS AND PROGRAM ADMINISTRATION COMMITTEE

- I. SUBJECT:** Proposed Disclosure, Gift, and Campaign Contribution Policies
- II. PROGRAM:** Administration
- III. RECOMMENDATION:** Staff recommends that the Committee direct Staff to draft policies and regulations described in Section C, which would be based on the recently adopted CalSTRS policies. If the Committee accepts the Staff recommendation, Staff will provide actual regulatory and policy language at an upcoming Committee meeting.

IV. ANALYSIS:

A. Executive Summary

California public officials and employees are governed by a myriad of statutes, regulations, and policies that restrict gifts, campaign contributions and communications. These rules are intended to limit improper influence and to improve transparency in governmental decision-making. The California State Teachers' Retirement System (CalSTRS) has adopted several new policies and is seeking to adopt regulations that will supplement the state law that addresses these issues.

In October 2006, staff informed the Committee of the status of CalSTRS' actions and provided a comparison of CalSTRS' proposals to state law and to CalPERS' regulations and policies. In December 2006, staff provided an update on CalSTRS' actions and was directed by the Committee to provide an updated description of CalSTRS' policies as well as a comparison of those policies to (1) state law, (2) CalPERS' regulations and policy, and (3) former CalPERS policies that were invalidated by the litigation described below. Attachment 1 contains

the description and comparison. All of the CalSTRS policies have been adopted and have become effective, except for the campaign contribution restrictions discussed on page 1 of Attachment 1. These restrictions will be adopted as regulations pursuant to the Administrative Procedures Act ("APA").

Section B, below, provides the history of CalPERS' pay-to-play rules adopted in 1998, but invalidated in litigation brought by then State Controller, Kathleen Connell.

Section C, below, provides staff's analyses regarding each of the policies adopted by CalSTRS and staff's recommendation regarding each policy.

Finally, under separate cover, the CalPERS Legal Office will be providing an analysis of the Board's authority to adopt the policies and regulations under discussion in this item. The legal analysis may influence the substance and form of the actual policies and/or regulations proposed by Staff.

B. CalPERS' Previously Adopted Pay-to-Play Policies

In early 1998, the CalPERS Board adopted policies and implementing procedures that prohibited the receipt and solicitation of campaign contributions. Specifically, BD-98-01 provided that:

No person who is engaged in business for gain, or seeking to engage in business for gain, with CalPERS, may make any political contributions to a CalPERS fiduciary during the tenure of the CalPERS business relationship, or during the period they are seeking to establish such a relationship.

BD-98-02 provided that:

CalPERS fiduciaries are prohibited from knowingly soliciting any contribution for any purpose from a "person" who is engaged in business for gain, or seeking to engage in business for gain, with CalPERS. However, such persons may make unsolicited contributions to charities in the name of CalPERS or any CalPERS fiduciary.

Implementing procedures defined some of the operative terms:

"Business for gain" was defined to mean any contract for goods or services, and any investment-related contract (including without limitation a limited liability company or partnership agreement), but not contracts between CalPERS and employee associations.

“Contract” and “agreement” was defined to include only those contracts or agreements that entitled the contractor to fees or payments in excess of \$25,000 in a single year.

“Person” was defined to mean a natural person or business entity of any type, and includes all directors, partners, officers or agents of such a business entity. “Agent” was defined to mean a person who is acting for, and with the apparent authority of, the person who has or is seeking a CalPERS business relationship.

The “tenure of the CalPERS business relationship” was defined to mean the duration of the contract or agreement with CalPERS, including any amendments that extend the duration.

“During the period [the person is] seeking to establish [a CalPERS business relationship]” was defined, for competitive solicitations, to begin with the issuance of the solicitation and end upon the award of the contract. For contracts not subject to competitive bidding the period was defined to begin when CalPERS first communicates to the potential contractor about an opportunity, and end upon award of the contract. For investment related contracts the period was defined to begin when the due diligence process started until the contract was negotiated or a decision was made not to invest.

Those persons who knowingly violated the policy during a competitive contract process would be disqualified from the contract award, but could protest the decision. Those persons who knowingly violated the policy during an ad hoc selection process, e.g., private equity partnership investment, would “be subject to a Board decision to decline to pursue the business relationship.” Those contracting parties who knowingly violated the policy would be subject to termination or a withholding of future funding at the discretion of the Chief Executive Officer in the case of those contract decisions delegated to him/her and otherwise to the Board.

These Board policies were challenged and invalidated in an action brought by then State Controller Kathleen Connell on the ground that the policies should have been adopted as regulations in compliance with the procedures and requirements of the APA.

The APA provides that a state agency policy or procedure that sets forth a rule or standard of general application to either implement, interpret or make specific the law enforced or administered by the agency or that governs the agency's procedures must be adopted as a regulation pursuant to the requirements and procedures of the APA. There is an exception for policies that relate solely to the internal management of the state agency. The court, in the case initiated by the

State Controller, found that CalPERS' policies did not fall within the internal management exception to the APA because the policies sought to regulate the relationships between certain members of the Board and a large class of outside parties: all actual or prospective contractors with CalPERS. Accordingly, the court found that the challenged policies did not relate only to the internal management of the agency, but rather, sought to control the behavior of conduct of a large class of persons who were not members of the agency by setting forth a standard of conduct applicable to those persons. The court held that the challenged policies constituted regulations within the meaning of the APA in the form of standards of general application to those persons or entities doing business with or seeking to do business with CalPERS. The challenged policies were therefore invalidated on the ground that CalPERS had not proceeded in the manner required by law for their adoption.

The State Controller had also challenged the policies on the grounds that they violated the First and Fourteenth Amendments, but since the court found that the policies were invalid for failure to comply with the APA, the court found it "unnecessary and inappropriate" to address the Controller's other legal challenges.

C. Staff Recommendations

Staff recommends that CalPERS adopt regulations and/or policies as described below. If the Committee agrees, Staff will draft actual policies and/or regulations for the Committee's review at an upcoming Committee meeting or as discussed below.

- Campaign Contribution Limits. Preliminarily, Staff recommends that CalPERS adopt campaign contribution regulations based on the regulations that have been proposed by CalSTRS. The purpose of these regulations would be to avoid even the appearance of improper influence. Staff, however, recommends waiting until CalSTRS finalizes its regulations before taking action. This will give CalPERS the benefit of any public input that is received by CalSTRS. Two public meetings are currently scheduled to discuss CalSTRS' proposed regulations. The first is scheduled for February 21, 2007 and the second is scheduled for March 15, 2007. In the interim, the Legal Office will continue to conduct its own research regarding the potential legal challenges that might be brought if CalPERS were to propose regulations based on CalSTRS' proposed regulations.

See Attachment 2 for CalSTRS' proposed regulations.

- Gift and Charitable Giving Limits.

CalSTRS' gift limit threshold is the same as the limit found in state law. Staff believes that state law adequately limits gifts to CalPERS Board members and employees. In addition, having a different definition of a "gift" than the definition contained in state law may lead to confusion or conflicting rules. Therefore, Staff does not recommend adopting a similar gift limit based on CalSTRS' policy.

Staff does recommend CalPERS adopt a policy or regulation based on CalSTRS' policy that limits charitable contributions solicited by Board members to \$250. Such contributions are not addressed by state law currently and can lead to the appearance of improper influence, e.g., when contributions are solicited for politically oriented organizations that are nonprofits. Staff recommends that contributions to charities that are registered as a 501(c)(3) under the Internal Revenue Code, e.g., the United Way, be exempted from this limit.

See Attachment 3 for CalSTRS' policy.

- Gift, Campaign, and Charitable Giving Disclosure. Staff recommends adopting a policy or regulation based upon CalSTRS' increased disclosure obligations relating to gifts, campaign donations, and charitable giving, by requiring certain business partners and prospective business partners to disclose these payments.¹ Again, staff believes donations to nonprofits that are registered as a 501(c)(3) under the Internal Revenue Code should be exempt from this disclosure requirement.

See Attachment 3 for CalSTRS' policy.

- Recusal Obligations. With regard to recusal obligations resulting from the acceptance of gifts, staff believes that state law adequately addresses this issue by requiring Board members to recuse themselves when they receive gifts aggregating over \$390 during a 12 month period. Therefore, Staff does not recommend that CalPERS adopt a policy based upon CalSTRS' policy that requires recusal when a Board member receives \$250 as opposed to \$390. Staff does not believe a change from \$390 to \$250 is material enough

¹ The new version of CalSTRS' policy is unclear what the reporting thresholds are for gifts and charitable contributions, but the thresholds reported on page 3 of Attachment 1 have been confirmed by CalSTRS staff. Under a previous version of the disclosure policy CalSTRS required disclosure of gifts over \$50, charitable contributions solicited over \$50, and campaign contributions over \$100. That disclosure is required via contract and in requests for proposal and may continue to be required.

of a difference to warrant the confusion that may result from a requirement that differs from state law.

With regard to recusal obligations resulting from the acceptance of campaign contributions, staff recommends adopting a policy or regulation based upon CalSTRS' policy that requires recusal when campaign contributions of over \$250 are received. In addition, since at least one CalPERS Board member may be subject to a similar recusal obligation pursuant to Government Code Section 84308², it is reasonable to apply a similar recusal obligation to all Board members.

See Attachment 3 for CalSTRS' policy.

- Communication Disclosure. Staff recommends adopting a policy or regulation based upon the CalSTRS policies regarding communication disclosures with the following exceptions.

First, CalSTRS provided an exception to the disclosure requirements for certain communications that are "general in nature and content," which are defined to mean:

- (1) Those with regard either to the nature of the party's business or interests or with regard to public information regarding CalSTRS;
- (2) a simple expression of the party's interest generally in doing business with CalSTRS or having CalSTRS invest in or with the party communicating with the Board member; or
- (3) a simple expression by the Board member in relation to the performance of an investment or service provided to CalSTRS. Staff does not recommend making the same exception since CalSTRS broadly defines communications that are "general in nature and content."

Staff believes that the aforementioned exceptions are ambiguously drafted and could be broadly interpreted to exclude the disclosure of communications that are intended or required to be disclosed pursuant to Government Code Section 20153. Staff therefore does not recommend adopting the CalSTRS' exceptions to communication disclosures.

Second, staff recommends that, unlike CalSTRS' policy, all disclosures required to be made under the CalSTRS' policies should be disclosed to the Board by the General Counsel. This decision relieves the General Counsel of

² Government Code section 84308 governs contributions from persons with pending applications for licenses, permits or other entitlements.

the burden of deciding what communications are material or nonmaterial. Making such a determination, in staff's opinion, is too subjective.

See Attachment 4 for CalSTRS' policy.

- Undue Influence Policy. Staff recommends adopting a policy or regulation based upon the CalSTRS undue influence policy.

See Attachment 4 for CalSTRS' policy.

- Disclosure of Placement Agent Fees. Staff recommends adopting a policy or regulation based upon CalSTRS' disclosure policy regarding placement agent fees.

See Attachment 5 for CalSTRS' policy.

- Pledge Requirement. Staff recommends adopting a policy or regulation based upon CalSTRS' pledge requirement.

See Attachment 6 for CalSTRS' policy.

- Nepotism Policy. Staff recommends adopting a policy or regulation based upon CalSTRS' nepotism policy.

See Attachment 7 for CalSTRS' policy.

V. STRATEGIC PLAN:

This supports Goal II of the Strategic Plan which calls for CalPERS, as an organization to "foster a work environment that values quality, respect, diversity, integrity, openness, communication, and accountability.

GINA M. RATTO
Deputy General Counsel

PETER H. MIXON
General Counsel